Loretto v. Teleprompter Manhattan CATV Corp, 458 U.S. 419 (1982). The decision in *Loretto* is applicable to the under recovery of costs due to the pricing of interstate access. AT&T misapplies the relevance of the takings clause.[32] TELRIC pricing provides no opportunity for an incumbent LEC to earn a reasonable return on its investment because such pricing necessarily forces the LEC to receive total revenues that are less than total costs. Further, the investment upon which the takings clause requires a reasonable opportunity to earn a reasonable return is the investment used to provide the regulated service, not the overall investment. Finally, the problems presented here are of a greater magnitude than those facing the regulated firms in *Hope* and *Duquesne*. TELRIC pricing creates a virtual certainty that the incumbent LEC will be denied the opportunity not only to earn a return on its investment in the regulated assets, but also to secure the return on those regulated assets by the end of their useful lives.

Finally, Sidak and Spulber explain that a takings can also occur when a regulator redefines the intended use of the private property unless it also preserves a reasonable opportunity to recover the full economic costs associated with the new purpose. The requirements to provide unbundled network elements clearly redefine the purpose for which the incumbent LEC's investment was made. Applying the Supreme Court's decision in *Northern Pacific Railway Co. v North Dakota*, 236 US. 585 (1915), Sidak and Spulber note that if the regulated firm has held itself out as an integrated network providing service directly to customers, it cannot be compelled to rededicate that network to providing service to competitive

---

[32] *Id.* at 39.

firms at prices that do not permit it to recover its full economic costs.

As stated in the *Economic Report of the President*, "recovery of costs legitimately incurred pursuant to regulatory obligations would be warranted."[33] In its comments, USTA provided empirical evidence regarding the costs associated with the TIC, the depreciation reserve deficiency and the operation of the separations rules which must be recovered for the reasons stated above. USTA also provided mechanisms for recovery of the components of the TIC which could be identified and the federal depreciation reserve deficiency. Remaining costs allocated to the interstate jurisdiction must continue to be billed to IXCs until the separations rules are changed. USTA will discuss recovery of the TIC in Section IV below. Here, USTA will respond to AT&T's position that price cap LECs should not be permitted to recover fully the depreciation reserve deficiency.

E. The Commission Must Take Action to Permit Price Cap LECs to Recover the Federal Depreciation Reserve Deficiency.

The federal depreciation shortfall as calculated by USTA is $4.48 billion. As USTA pointed out, this is a conservative figure. The actual disparity between regulatory book value of net plant and the economic value of LEC capital may substantially exceed that calculation.[34] It is also important to note that LEC depreciation rates lag far behind those of its largest competitors. In Attachment 15 of USTA's January 29, 1997 comments, Strategic Policy Research (SPR),

[33] *Economic Report of the President*, Transmitted to the Congress, February 1997, at 205.

[34] USTA Comments, January 29, 1997 at 72-78 and at Attachments 13-15.

compared the depreciation rates of LECs with those of MFS, TCI, AT&T and MCI.[35] The results show that LEC depreciation rates fall far short of reflecting declines in economic value.

MFS (now WorldCom), is one of the largest competing local exchange carriers. It provides essentially the same service using the same general types of plant as the LECs with one exception. MFS utilizes more fiber optic cable which is generally depreciated more slowly than circuit equipment, switching equipment or copper cable. Yet, MFS depreciates plant 30 percent faster than the average incumbent LEC. TCI is the largest provider of cable television services. It, too, uses the same general categories of plant as incumbent LECs, although cable is a larger component of TCI's plant. TCI depreciates plant 25 percent faster than incumbent LECs. Both MCI and AT&T use the same general types of plant as incumbent LECs. AT&T and MCI utilize more switching and circuit equipment. Switching and circuit equipment are generally depreciated more rapidly than cable. AT&T depreciates plant 53 percent faster than incumbent LECs and MCI depreciates plant 36 percent faster than incumbent LECs. It is clear that the slow depreciation rates granted incumbent LECs place them at a competitive disadvantage.

In its comments, AT&T submits two studies which argue that the problem of inadequate capital recovery is insignificant and that, in any event, price cap LECs should not be entitled to recover those amounts.[36] As noted above, AT&T advocates a $10 billion windfall for IXCs.

---

[35]Jeffrey H. Rohlfs, Charles L. Jackson and Ross M. Richardson, "The Depreciation Shortfall", USTA Comments, January 29, 1997, Attachment 13 at 19-21. [SPR].

[36]Richard B.Lee, "Analysis of Local Exchange Carrier Depreciation Reserve Levels" [Lee] and Affidavit of Patricia D. Kravtin and Lee L. Selwyn [Kravtin and Selwyn].

assuming that none of that amount is passed through to customers. Appended hereto at Attachment 4, SPR refutes the AT&T studies.[37] Both AT&T studies contain major flaws.

SPR points out that the Lee Study improperly ignores economic depreciation. In a competitive environment, the regulatory book value of plant should approximate economic value. If not, incumbent LECs will not be able to compete with other providers. Economic depreciation is even more essential if incumbent LECs are required to sell unbundled network elements. SPR also explains that economic depreciation of LEC plant is likely to be at least as rapid as for comparable AT&T plant--regardless of how competitive conditions differ between the long distance and LEC industries.

The Kratvin and Selwyn study is based on a theory of regulation which is legally and economically unsupported and which, if ever adopted, would stifle any investment in the telecommunications infrastructure. Kratvin and Selwyn's analysis of the necessary expenditures for the period from 1990 through 1995 are so ridiculously low that there is no possibility that the current network could be maintained and universal service supported at such levels. This is particularly surprising given the fact that in previous filings Selwyn complained that incumbent LEC investment was too low. Investment at the levels suggested by AT&T would result in a severe deterioration of the network in a short period of time. Kratvin and Selwyn's study is also based on an incorrect assumption regarding price cap regulation. They state that the price cap LECs were not entitled to recover investment made after price cap regulation was mandated by

[37]SPR, "The Depreciation Shortfall Reply Comments", February 14, 1997, Attachment 4.

the Commission. Such an assumption is also legally and economically unsupportable. The vintage and composition studies performed by Kratvin and Selwyn fail to consider the fact that if the incumbent LEC network were to be built today, much of the copper cable plant would be replaced by fiber-optic and loop carrier systems. In their utilization study, Kratvin and Selwyn use a definition of basic service which is too narrow and ignore the fact that the policies of AT&T created disincentives to continue investing in analog switches.

III. THE MARKET-BASED APPROACH PROPOSED BY USTA WILL ENSURE THAT CONSUMERS RECEIVE THE FULL BENEFITS OF COMPETITION. (Paragraphs 161-217).

"[A] market-based mechanism offers large potential advantages, including a lower amount of intervention by regulators and a more clear cut process for moving to a deregulated market. It is this rapid move to competitive and deregulated markets that will most benefit consumers."[38] A market-based approach provides the best means to achieve the pro-competitive, deregulatory telecommunications framework established by the Act. The Commission certainly relied on a market-based approach in the interexchange market. The Commission did not prescribe reductions in AT&T's rates to encourage competition, rather the Commission removed the regulatory constraints on AT&T as competition developed.

A. Phase I of the Market-Based Approach Should Reflect the Current Marketplace and Should Meet the Requirements of the Act.

The market-based approach is based on the concept that regulation should be tailored to reflect the development of competition. Incumbent LECs should be permitted to adjust their

---

[38]Citizens for a Sound Economy at 1.

prices and services as soon as economic conditions warrant. However, the flaw in the market-based approach proposed in the NPRM and similar approaches advocated by others is that they do not reflect the current environment. They are premised on the false assumption that competition does not currently exist. Such an assumption simply ignores reality. "Facilities-based competition is already in full swing across the nation...UNE-based competition is underway as interconnection agreements that are being negotiated and completed lay the groundwork [for the] entry and expansion of competitors...entrants such as AT&T, MCI, Sprint, WorldCom, Time Warner and other competitive entrants are not "infants," but large, well-established and experienced competitors."[39]

In several attachments appended hereto. USTA provides a recent snapshot of the current competitive marketplace. This empirical data clearly demonstrates that competition in the access market exists and continues to grow at a phenomenal rate. Facilities-based competitors are already in operation and others have applied and received certification for facilities-based entry. Many facilities-based competitors have publicly announced their capital investment plans, so that competition has indeed moved from potential entry to planned entry. Attachment 5 contains an updated list of the markets where competitive provider networks exist. This list demonstrates the expansion of such networks into secondary and tertiary markets. Attachment 6 provides a summary of access competition. It shows that there are 326 competitive networks, 912 collocation cages or virtual equivalents, 111,193 DS1 equivalents, 140,986 local interconnection

[39]Sidak and Spulber at 33.

trunks and 2.466 CLEC NXX Codes. Attachment 7 provides a listing of CLEC approved and pending certifications by state. Attachment 8 shows that there are 688 interconnection agreements underway. Further, CAPs and CLECs and long distance carriers providing local service have developed a significant installed base of digital switching capability. These carriers had 660 switches in 1996 and are expected to have 701 by the end of 1997. These switches served an installed base of 2.3 million lines in 1996 and this number is expected to grow to 4.0 million by the end of 1997.[40] Phase I must reflect the fact that robust competition already exists and is accelerating at a pace which demands flexibility.

1. USTA's Proposed Trigger for Phase I is Consistent With the Act.

USTA proposed that in order to obtain relief in Phase I, there must be a state-approved interconnection agreement or a Statement of Generally Available Terms. This would apply separately for each state within which a price cap LEC provides local exchange service. This trigger ensures that the requirements of Sections 251 and 252 are met. These requirements, including interconnection, access to unbundled elements, resale, collocation and reciprocal compensation, dramatically reduce economic barriers to entry. "This...has the effect of significantly reducing a competitor's sunk cost investment needed to enter the market. In modern economic theory, sunk costs of entry are the key to measuring barriers to entry as part of a market power analysis...It is unquestionable that in addition to the 1996 Act, coupled with the Interconnection Order, a state-approved interconnection agreement or Statement of Generally

---

[40]U.S. Central Office Equipment Markets Report, 1996 Edition, Northern Business Information.

Available Terms reduces the absolute level of sunk cost needed to enter the market."[41]

With an interconnection agreement, a competitor will not need to invest in loops, switches or transport to provide exchange access, if the competitor "wins" the customer. A competitor will also have access to nondiscriminatory operations support systems. The availability of unbundled network elements will also increase, not only alternatives to traditional LEC access services, but also the scope of competition by facilitating entry in areas that would not have merited facilities investment. There is no need for additional regulatory requirements.

AT&T argues that the constraint to win the local customer as a precondition to being able to provide local exchange access using unbundled network elements will significantly limit their use. However, this precondition applies to the use of the unbundled switch. Exchange access from an IXC point of presence to the end user utilizes other unbundled network elements where the constraint does not apply. It would be impractical to provide exchange access over a customer's dedicated loop and not provide local exchange service. "Purchasing an unbundled loop or the unbundled local switch gives the CLEC exclusive use of the dedicated facility--in the case of the unbundled switch the dedicated facility is the port/line card...If a CLEC is targeting and wins an exchange access customer--using the customer's unbundled loop and local switch--the costs associated with obtaining that customer's local exchange business is practically zero. It is definitely not a barrier to entry."[42]

---

[41]Schmalensee and Taylor, USTA Comments, January 29, 1997, Attachment 1 at 27-28.

[42]Schmalensee and Taylor at 22-23.

In addition, USTA's Phase I trigger is consistent with the *Merger Guidelines* of the Department of Justice and the Federal Trade Commission. According to the *Guidelines*, firms are treated as participating in the market if they are likely to enter profitability within one year in response to a margin between market price and cost without any significant expenditure of sunk costs.[43] The availability of unbundled network elements and resale opportunities provide an effective and efficient substitute to the Part 69 access regime to allow timely and profitable entry into the access market.

CompTel argues that only full service providers will benefit from unbundled network elements.[44] While USTA agrees that the competitor must "win" the customer, the unbundled network price will necessarily constrain the facilities-based price in a competitive market. If the market is permitted to operate efficiently, access prices will decline. Further, the Act contains specific prohibitions which will prevent unreasonable discrimination.

2. USTA's Phase I Relief is Essential to Match the Phase I Market.

USTA proposed that once the Phase I trigger is satisfied, regulation should be reformed to permit consolidation and simplification of the current price cap basket structure, elimination of Part 69 codification for price cap LECs, deaveraged switched access service rates by geographic area and class of customers, volume and term discounts, contract-based tariffs and responses to RFPs, and the deregulation of new services. There is no reason to delay the implementation of

---

[43]Schmalensee and Taylor, USTA Comments, January 29, 1997, Attachment 1 at 26-27.

[44]CompTel at 4-8.

these reforms as suggested by the NARUC,[45] or to consider them in a separate proceeding as suggested by Sprint.[46] "At this stage of market development, it is essential that asymmetric regulatory constraints be reduced to the greatest possible extent. It is important that this condition be met not only for the tangible productive efficiencies generated...but also for the benefits gained by those remaining customers both wholesale and retail."[47] Further delay would only delay the benefits of competition for consumers.

These issues have already been before the Commission in another proceeding, CC Docket No. 94-1. Now the case is even more compelling because competition is accelerating at an even faster pace due to the requirements of the 1996 Act to open local markets to competition. The Act permits ubiquitous access to unbundled network elements which guarantees the availability of substitutable services. Opportunities for resale are enhanced. The Commission must not delay its consideration of these issues. Competitors, consumers and incumbent LECs need to know how the current system is to be reformed in order to allow them to make informed decisions in the marketplace.

MCI claims that such relief is not warranted because price cap LECs do not utilize the pricing flexibility which has already been provided.[48] While no zone flexibility is allowed for local switching, zone density pricing is allowed for a limited number of transport services where

---

[45]NARUC at 8-9.

[46]Sprint at 37-38.

[47]Schmalensee and Taylor, USTA Comments, January 29, 1997, Attachment 1 at 29.

[48]MCI at 52-55.

collocation is operational. Such limited relief does not permit LECs to adequately respond to current competition and is not sufficient to ensure economic pricing. The introduction of zones was simply the first step in allowing price cap LECs to better reflect the costs of providing service. As USTA proposed in its comments, zones should be redesigned to reflect the competitive realities of specific markets.

The price cap basket simplification and elimination of Part 69 codification for price cap LECs will enhance economic efficiency by improving their ability to respond to competitive market developments. Price cap regulation, as well as state-approved interconnection agreements, will constrain prices while access to unbundled network elements will prevent anticompetitive behavior.

Deaveraging switched access rates was supported by a number of parties. The Illinois Commerce Commission noted that it supported granting the flexibility to deaverage access charges and to adopt volume and term discounts even before Phase I.[49] Deaveraging switched access rates more closely aligns rates with the way costs are incurred and will enhance efficiency. This is particularly important for Phase I because efficient entry decisions will be made at that stage.

Permitting incumbent LECs to respond to competition by offering volume and term discounts, contract-based tariffs and responses to RFPs will also lead to efficiency improvements. Contrary to the assertions of WorldCom, Time Warner and Sprint, there is no

---

[49]Illinois Commerce Commission at 21. *See*, also, Sprint at 41-42, TCI at 28 and WorldCom at 79.

evidence that permitting incumbent LECs to respond to competition in any of these ways will harm competitors.[50] These are common business practices which are readily utilized by all competitors. The General Services Administration and the Department of Defense recommend that the Commission eliminate the prohibition against competitive response tariffs at the present time. "A local exchange carrier would not be able to submit a competitive response tariff if competition were not present, so that a test reflecting the general development of competition is not required. Since interexchange carriers are now permitted to contract without such constraints, the present rules give IXCs an undue advantage over LECs. Also, the present restrictions on LECs unnecessarily limit the number of responses in competitive procurements."[51] Obviously customers will benefit from the elimination of restrictions on these competitive response items since they will be able to take advantage of more service options, more competitive prices and more service providers.

That has certainly been the case in California, where the PUC has granted incumbent LECs the ability to enter into contracts:

> In our view, it is appropriate that the LECs should have greater contracting flexibility in competitive areas. Firms compete in part on the basis of their ability to tailor their services to meet the needs of specific customers, and these customer-specific arrangements may also reduce the LECs' cost of serving the customer by eliminating services that the customer does not need but that are part of a tariffed package. And if the tailored price makes some contribution toward the fixed costs of operating the network, the LEC's other customers are better off than they would be if the LEC's competitor won

---

[50]WorldCom at 80-86, Time Warner at 31-33 and Sprint at 43-45.

[51]GSA/DOD at 24.

the customer's business.[52]

There is no need to renew the "fresh look" option as suggested by ALTS.[53] Access customers are knowledgeable, sophisticated businesses who are aware of the changing market and can negotiate for the contract terms which best meet their needs. Certainly the negotiation process is preferred by the Act and is a more efficient means to determine the terms of contracts. Using regulation to mandate certain terms will not allow the parties to accommodate unique circumstances.

Finally, given the evolution of new technologies and services, it is imperative that incentives to develop and offer new services not be hindered by unnecessary regulatory constraints that only serve to increase costs and fail to ensure that the needs of consumers are served. Therefore, the Commission should deregulate new service offerings, so long as the core access service offerings remain available. The availability of unbundled network elements, as well as the non-discrimination and complaint procedures contained in the Act provide sufficient protection for customers.

B. In Phase II, the Presence of Competition Will Provide Sufficient Safeguards to Remove a Service From Price Cap Regulation.

In Phase II, USTA is proposing to permit the removal of a service from price cap regulation in a specific geographic area upon a showing that competitive alternatives are

---

[52] *In the Matter of Alternative Regulatory Frameworks for Local Exchange Carriers. And Related Matters*, Public Utilities Commission of the State of California, I.87-11-033, September 15, 1994.

[53] ALTS at 11.

available.

1. The Phase II Trigger Should Rely on the Presence of Competition.

As Schmalensee and Taylor explained, in order to classify a service in the Phase II category, the Commission should determine if the degree of competition from firms currently in the market is sufficient to prevent the incumbent from profitably holding price above competitive levels and if barriers to entry are sufficiently low so that entry from new competitors would prevent an incumbent from pricing above competitive levels.[54] If the answer to either is yes, then the service should be considered in Phase II and should qualify for Phase II regulatory relief.

USTA's plan is consistent with this approach. USTA proposes that a state-approved interconnection agreement and a showing that the unbundled elements are in use will ensure that no significant barriers to entry exist and that competition is sufficient to constrain pricing behavior. This is certainly a more conservative approach than that taken by the Commission in providing regulatory relief to AT&T. AT&T was declared to be a non-dominant carrier despite the fact that the interexchange market was not open to all competitors the way that the local market is now open to all competitors.

The demonstration that actual competition exists could include evidence that barriers to entry are removed, that an interconnection agreement has been approved by state regulators, that NXX codes are assigned to competitors, that minutes are being exchanged with one or more competitors as well as a list of competitors in the market, a list of services offered by competitors

---

[54]Schmalensee and Taylor, USTA Comments, January 29, 1997, Attachment 1 at 34.

and a description of the geographic area served by competitors. Such a showing ensures that the market is sufficient to prevent non-competitive pricing.

2. In Areas Where Competition Has Been Shown to Exist, Services Should Be Removed From Price Cap Regulation.

In geographic areas where competition has been shown to exist, services should be removed from price cap regulation and be subject to streamlined regulation, since the market will constrain prices. Tariff filings should be permitted on one day's notice without cost support. Such tariffs would be deemed lawful. Title II requirements would still apply to these services.

C. Forbearance is Warranted for Special Access, Collocated Dedicated Trunked Transport, Directory Assistance and Services in the Interexchange Basket.

As described in USTA's comments, the criteria contained in Section 10 of the Act has been met and forbearance is required for special access, collocated dedicated trunked transport, directory assistance and the services in the interexchange basket identified by USTA. Entry barriers are sufficiently low and competitors are present to such an extent that the market will ensure that rates are just and reasonable. Regulation is no longer required for the protection of consumers. In fact, continued regulation will harm consumers by denying them even more options in the marketplace. Finally, regulation is no longer required to serve the public interest. Each service is subject to competition. Continued regulation of these services will not only deny consumers the full benefits of efficient competition, but will also add unnecessary costs. The Commission must forbear from regulating these services.

D. The Act and the Competitive Market Provide Sufficient Safeguards.

In its comments, USTA has shown that predatory pricing, cross-subsidization and price squeeze are highly unlikely. The Act, which eliminates barriers to entry and which prevents pricing below cost, addresses any concerns regarding predatory pricing. Predatory pricing only exists when a firm prices below cost to force competitors out of business. Competitors such as AT&T and MCI will not be forced out of business. Price cap regulation continues to reduce the ability and incentive of a regulated firm to cross subsidize and the competitive market will further prevent cross subsidization in Phase II.

The Act also provides sufficient safeguards against the possibility of a price squeeze. Several parties contend, however, that vertically integrated LECs will have greater opportunities to price squeeze.[55] As Schmalensee and Taylor point out, this is clearly a case where what may be a concern in theory, is not a concern in reality.[56] As they explain, in order to use such an incentive to its advantage, a price cap LEC would have to violate the imputation requirements, achieve the right market share and hope that interexchange competitors do not take advantage of alternative access arrangements. The Commission itself recognizes that "as long as the incumbent LEC is required to offer unbundled network elements and resale of retail services, an attempted price squeeze is unlikely to be an effective anti-competitive tool."[57]

[55]MCI at 35-36 and AT&T at 85.

[56]Schmalensee and Taylor, USTA Comments, January 29, 1997, Attachment 1 at 42. *See, also,* Schmalensee and Taylor (Reply) at 12-15.

[57]*In re Applications of Pacific Telesis Group Transferor and SBC Communications, Inc., Transferee, For Consent to Transfer Control of Pacific Telesis Group and its Subsidiaries,*

A price squeeze would involve upstream (access) as well as downstream (interexchange) components. If incumbent LECs were to maintain access charges at excessive levels, the LECs would invite erosion of their access revenues from their most lucrative subscribers by competing access providers. The downstream component would not be successful either. One purpose of a successful price squeeze is to increase barriers to entry in the downstream market. That is not a concern in the interexchange market. A LEC would not be able to recoup the interexchange profits it had forgone in implementing a squeeze.[58]

IV. RATE STRUCTURE MODIFICATIONS SHOULD PERMIT FLEXIBILITY AND FULL RECOVERY OF COSTS. (Paragraphs 55-139).

The rate structure for the recovery of costs allocated to interstate access for price cap LECs should be simplified to permit flexibility and the full recovery of costs. The rate elements for price cap LECs should not be codified. As USTA discussed in great detail in CC Docket No. 94-1, the current codified rate structure is no longer required for price cap LECs. It creates unnecessary regulatory burdens which increase costs by serving as a barrier to innovation.

A. CCL Should be Recovered on a Flat Rate Basis. (Paragraphs 59-63).

The majority of commenting parties agree that the current method of recovering CCL charges is not appropriate and recommend that CCL costs be recovered through a flat rate, per line charge paid by interexchange carriers.[59]

Report No. LB-96-32, *Memorandum Opinion and Order*, January 31, 1997 at ¶ 54.

[58]*See*, *Brook Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 US 209 (1993).

[59]USTA at 55, Citizens Utilities at 27-28, State Consumer Advocates at 16, Missouri PSC at 2, U S WEST at 51, BellSouth at 68, Cable and Wireless at 10, MCI at 76, District of

A flat rate charge to IXCs will not conflict with Section 254(g) of the Act as alleged by WorldCom.[60] As the Tennessee PSC explains, costs are both fixed and variable and specific costs will differ from area to area. There is no reason why IXCs cannot average a flat rate CCL charge into their rate structure just as they must currently average disparate per minute CCL charges. They also average property taxes, depreciation, electricity and labor costs to derive rates which must comply with the requirements of the Act.[61] There is no conflict in establishing a flat rate CCL charge and the rates charged to IXC customers.

B. The Administrative Burden of Increasing the SLC Cap on Second Lines Outweighs the Benefits.

In its comments, USTA explained that increasing the SLC on second lines would be administratively burdensome because there is no practical or efficient way to identify such lines.[62] USTA agrees with the Illinois Commerce Commission that this would also provide incentives for customers to avoid such charges by simply purchasing second lines under a different name (another family member) or by purchasing additional lines from other carriers.[63]

Columbia PSC at 3-4, and Teleport at 26-27.

[60]WorldCom at 33-37.

[61]Tennessee PSC at 3-4.

[62]USTA at 56.

[63]Illinois Commerce Commission at 9.

C. One SLC Should Be Assessed for Each ISDN Facility. (Paragraph 69).

USTA continues to support assessing one SLC for each ISDN facility as the most economic pricing mechanism. As Ameritech states, such a mechanism would more closely reflect the manner in which the costs are incurred and avoid over recovery of loop costs from ISDN customers.[64]

D. LECs Should Have Flexibility to Recover Local Switching Costs. (Paragraphs 71-79).

USTA maintains that there is no need to mandate a specific rate structure for the recovery of local switching costs.[65] USTA recommended that line port charges be recovered through the new universal service funding mechanism since these charges are related to the provision of the defined universal service package. Price Cap LEC's should be allowed to recover all local switching costs, including line port charges if they are not recovered through universal service, in a manner that best reflects market conditions. Therefore, USTA opposes WorldCom's proposal that the Commission establish a "new mandatory access charge rate element for the line/port that should be segregated in a new, separate price cap service category".[66] WorldCom's approach is unnecessary given the fact that price cap LECs have little if any ability to raise local switching rates.

---

[64]Ameritech at 13. *See*, also, CompuServe at 19-21, GTE at 33-35, Microsoft at 7-8, and Pacific Telesis at 64-66.

[65]USTA at 57, Cincinnati Bell at 10, and SNET at 36-37.

[66]WorldCom at 39.

The flexibility which price cap LECs must be afforded should include the ability to reflect appropriately the manner in which the costs for switched access are incurred. Contrary to the comments of Ad Hoc,[67] this would include the ability to establish a call set-up charge[68] and to establish peak/off peak prices as needed to reflect actual usage.[69] Peak/off peak pricing should not be mandated as it could be administratively burdensome and could create incentives for IXCs to seek uneconomic alternatives.

E. The Rate Structure for Transport Must Ensure that the TIC is Fully Recovered. (Paragraphs 96-122).

Given that the TIC must be fully recovered as recommended by USTA in its comments, USTA believes that the current rate structure for recovery of transport costs is sufficient. The serving wire center to tandem portion of tandem switched transport is dedicated to one customer. It should not be treated as common transport as some parties suggest.[70]

All incumbent LECs are entitled to the full and complete recovery of the entire TIC amount. Identification of only certain components in no way suggests that only a portion should be recovered. The TIC represents actual, legitimate costs which have been assigned to the interstate jurisdiction and to the transport category through the correct application of the

---

[67] Ad Hoc at 5.

[68] California PUC at 6, Ameritech at 16, Citizens at 30, Competitive Policy Institute at 19-20, State Consumer Advocates at 33, Illinois Commerce Commission, Pacific Telesis at 67-69, and TDS at 24.

[69] Ameritech at 16-17, Citizens at 30, Competitive Policy Institute at 19-20, TDS at 24, Bell Atlantic/NYNEX at 40.

[70] MCI at 21 and WorldCom at 53-56.

Commission's rules. This is confirmed by the analysis included in the Bell Atlantic/NYNEX comments.[71] NYNEX New York compares its embedded, direct costs to the assignment of costs through the separations rules. The result is the residual TIC. Such costs simply cannot be eliminated as some parties suggest.[72] As the state consumer advocates point out, "the use of forward-looking costs does not eliminate the need to recover joint and common costs. The experience with the TIC indicates that it is appropriate to design rates that, in themselves, recover all the relevant, fully allocated costs, including joint and common."[73] Contrary to several comments, the Court of Appeals' decision in *Comptel v. FCC*, 77 F.2d 522 (DC Cir. 1996) does not require the elimination of the TIC. The Court remanded the case to the Commission and required the Commission to provide further justification as to the basis for the TIC.

USTA has provided the necessary data. As discussed in USTA's comments, the components of the TIC which are readily identifiable should be allocated to the appropriate rate elements and continue to be recovered. The remaining costs which relate to the operation of the separations rules and which support affordable local service should be removed from the per-minute of use TIC rate and bulk billed to IXCs based on interstate revenues or minutes until reform of the separations rules is completed. Rate of return LECs should also recover the service-related costs through the appropriate rate elements. The remaining TIC revenue requirement should continue to be recovered pursuant to Section 69.124 of the current rules until

---

[71]Bell Atlantic/NYNEX Comments, NYNEX New York Service - Specific Cost Study.

[72]AARP at 17, MCI at 87-88 and Competitive Policy Institute at 20.

[73]State Consumer Advocates at 35.

rate of return access reform and separations reform is completed.

F. Price Cap LECs Should be Afforded Flexibility to Recover SS7 Costs. (Paragraphs 123-128).

A strict rate structure for SS7 signaling costs should not be imposed. Some incumbent LECs do not have the necessary monitoring equipment to measure SS7 usage. Installing such equipment would be extremely expensive. LECs must be provided the opportunity to recover any such costs, if measurement is required.

G. A Rate Structure for New Technology Should Not Be Mandated. (Paragraph 139).

Given the rapid evolution of technology, there is no need to mandate a specific rate structure which could be rendered obsolete.[74] Such rigid regulation could provide a disincentive for incumbent LECs to invest in new technologies.

V. THE PRICE CAP RULES SHOULD BE CHANGED TO REFLECT THE MARKET-BASED APPROACH AND THE COMMISSION SHOULD NOT IMPOSE GREATER BURDENS BY REINITIALIZING RATES OR INCREASING THE PRODUCTIVITY FACTOR.

Some commenting parties refuse to acknowledge that the 1996 Act was meant to foster a deregulatory environment in the telecommunications industry not only for new entrants, but for incumbent LECs as well.[75] This is evidenced by their support of the prescriptive approach to access reform which retains and in many instances increases regulation of price cap LECs. For

---

[74] AT&T at 62-63.

[75] For example, see Section 402(b)(1)(A)(iii) which specifies streamlined regulation of LEC tariff filings. *See also Implementation of Section 402(b)(1)(A) of the Telecommunications Act of 1996*, Report and Order, FCC 97-23 (rel. Jan. 31, 1997).

example, Cable and Wireless[76] states that a prescriptive approach is necessary to provide a *guarantee of the pace and direction of changes* in price regulation. Congress did not intend for the Commission to increase regulation as competition intensifies. If the market and Congress are accelerating the pace of competition, the only way to create a suitable roadmap regarding the pace and direction of changes in price regulation is to adopt a market-based approach.

A. USTA's Proposed Price Cap Basket Structure is Consistent with the Market-Based Approach Yet Provides Sufficient Safeguards.

Retaining the current price cap basket and band structure is inconsistent with the deregulatory requirements of the 1996 Act. Requiring the codification of new rate elements and adding them to the "hundreds of access elements in some incumbent LECs' traffic sensitive and trunking baskets,"[77] is unnecessary. As AT&T explains, only four of these elements – local switching, tandem switching, common transport and dedicated transport – "account for virtually all of the [access] revenues."[78]

USTA's proposed price cap basket structure simply moves those four elements[79] from the basket level to the service category level and groups services with similar functionalities

---

[76]Cable and Wireless at 25.

[77]AT&T at 23.

[78]*Id.*

[79]USTA supports the removal of all special access services and switched access direct-trunked transport service, where collocation exists, from price caps as these services are substantially competitive in the current environment. Switched access transport services that are shared or where no collocation exists are grouped in the Tandem Switching and Transport service category.

together. In most cases, many of the services using these elements still require the use of the incumbent LECs' networks and, at this point in time, are not fully competitive. The proposed basket structure logically groups services into service categories – services associated with tandem switched transport are all in one service category, all local switching in another, all database services in a third, and finally all common line related rate elements in the fourth service category.[80] USTA's proposal is consistent with the suggestion of TCI that price-capped services facing different degrees of competition should be separated into different baskets or service categories.[81] Tandem switched transport services are more susceptible to competition than local switching while most database services already are facing stiff competition from other service providers.

As USTA proposed previously,[82] the LEC price cap basket structure should be simplified and follow functional lines of business. This is consistent with the manner in which the Commission structured AT&T's baskets in 1989 when it created separate baskets for Residential and Small Business, 800 Service, and Business. AT&T's basket structure made it easy for the Commission to streamline and ultimately to remove services as competition developed for individual services. Under USTA's proposal, unnecessary constraints have been removed while

---

[80]The common line rate elements remain in the price cap basket structure only as a means of price managing the recovery of interstate allocated common line costs. They are considered to be services.

[81]TCI at 27-28.

[82]*See* USTA's Petition for Rulemaking, Reform of the Interstate Access Charge Rules, RM-8356 (filed Sep. 17,1993); *see also*, Comments of Southwestern Bell Telephone Company at 30-32 and GTE's Comments at 62-64, CC Docket No. 94-1 (dated May 9, 1994).

sufficient safeguards to prevent cost-shifting are retained.

The proposed basket and band structure retains banding constraints at the zone level. The zone concept, which provided the ability to geographically deaverage prices based on demand densities for high capacity services, was a step in the right direction. Unfortunately, it imposed an additional layer of constraint that resulted in less, rather than more, pricing flexibility in the overall basket structure. USTA's proposed structure does not eliminate pricing constraints, but does expand the zone structure with fewer constraints.

The simplified structure proposed by USTA still contains sufficient safeguards to prevent cost shifting through the separate service categories. As explained in detail by Aliant,[83] the PCI for the Network Services basket would be:

$$PCI_t = PCI_{t-1} * (1+(GDPPI - X) +/- (\Delta Z_{basket} / R_{basket}))$$

where the R value would reflect all access services.[84] ΔZ would be the sum of all exogenous changes applied to service categories and/or zones. This PCI formula differs from the current formula only to the extent that access charge reductions that are exogenous adjustments to the Interexchange basket have been properly excluded. The upper limit formula for service categories and zones would be similar to the PCI formula except that there would be an upward limit of ten percent. As USTA explained in its comments, each service category or zone with an

[83] Aliant at 7-8.

[84] R is the base period quantity times the current price. *See* Section 61.45 of the Commission's rules.